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No. 93-1949

In The

Supreme Court of the United States

October Term, 1993

MED-THERAPY REHABILITATION SERVICES, INC., NS&H, INC. and BRIAN CENTER MANAGEMENT CORPORATION,

Petitioners,

vs.

DIVERSICARE CORPORATION OF AMERICA,

Respondent.

On Petition For Writ of Certiorari To The United States Court of Appeals For the Fourth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

Med-Therapy Rehabilitation Services, Inc. ("Med-Therapy") bought the stock of National Speech and Hearing Services, Inc. ("National") from Diversicare Corporation of America ("Diversicare")[1] pursuant to a Stock Purchase Agreement. The purchase price for National's stock was (1) a $750,000 cash payment from Med-Therapy to Diversicare and (2) a $700,000 promissory note (the "Note") to Diversicare from National that was guaranteed by Med-Therapy and its parent corporation.

Med-Therapy filed suit in April 1991. Med-Therapy claimed that Diversicare breached the Stock Purchase Agreement; committed common-law fraud; and violated state and federal securities laws. Diversicare filed a counterclaim and third-party complaint for the amount due under the Note that was part of the Stock Purchase Agreement.

Before trial, Med-Therapy opted against rescission. Med-Therapy chose instead to affirm the Stock Purchase Agreement and seek damages for breach of contract and for fraud. Med-Therapy's counsel began the trial by confirming Med-Therapy's election of remedies:

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[1] Diversicare Corporation of America has recently changed its name to DCAmerica Inc. Counselcare Ltd., a Delaware corporation, is the parent of DCAmerica Inc., and American HomePatient, Inc., a Delaware corporation, is a subsidiary of DCAmerica Inc.

The Court: ...And incidentally, you didn't sue for rescission here, did you?

Counsel: We have not. We are not specifically asking for rescission.

The Court: But you could have.

Counsel: We could have.

(Tr. Vol. II, 4-5).

The jury found against Med-Therapy on the breach-of-contract claims and awarded Diversicare $552,527, the exact amount Diversicare claimed was due under the Note. The jury found for Med-Therapy on its federal securities and common-law fraud claims and awarded damages totaling $553,527. The jury's verdict netted Med-Therapy a $1,000 victory.[2]

After hearing the jury's verdict, Med-Therapy *for the first time* invoked Section 29(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78cc(b)) and asked in post-trial motions that the district court ignore the jury's verdict and void the contract that Med-Therapy had just sued to enforce.

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[2] Med-Therapy wrongly states that Diversicare misrepresented in the Stock Purchase Agreement that National's cost reports complied with applicable Medicare regulations (Petition at 4). The jury specifically found on a special verdict form that Diversicare did not breach any representation or warranty in the Agreement.

The district court granted Med-Therapy's post-trial motion for rescission. The Court of Appeals reversed that decision.

REASONS FOR DENYING THE PETITION

SUMMARY OF ARGUMENT

MED-THERAPY'S DECISION TO AFFIRM THE PARTIES' CONTRACT AND SUE FOR DAMAGES PREVENTED MED-THERAPY FROM SEEKING POST-TRIAL RESCISSION.

Med-Therapy's petition ignores the critical fact that Med-Therapy opted before trial to enforce rather than to rescind the Stock Purchase Agreement between the parties. Med-Therapy sought rescission under Section 29(b) of the Securities Exchange Act of 1934 only after seeking breach-of-contract and fraud damages from the jury.

Med-Therapy fails to address the effect its election of remedies had on any right to rescissionary relief under Section 29(b). Instead, Med-Therapy implies that the Court of Appeals' ruling precluded Med-Therapy from choosing rescission under Section 29(b) because Diversicare had performed under the Stock Purchase Agreement (Petition at i, 6-7).

The question Med-Therapy poses for review by this Court is not even an issue in this case. The district court gave Med-Therapy a choice of remedies at trial. This case is about the consequences once Med-Therapy made its choice.

The Court of Appeals held that a plaintiff may not both affirm and rescind a contract for the purchase of securities (App. 8-11). After asking that the jury enforce the Stock Purchase Agreement and award Med-Therapy damages for breach of that contract and for fraud, Med-Therapy had no right under Section 29(b) to post-trial rescissionary relief inconsistent with the jury's verdict (*Id.*). The Court of Appeals held that Med-Therapy and the district court had to honor the jury's verdict (*Id.*).

No authority suggests this ruling was incorrect. It is consistent with prior decisions of this Court and with the holdings of other courts that require a securities fraud plaintiff to choose between available remedies. It recognizes that trial courts do not have "broad...powers" to change jury verdicts (Petition at 15). This Court should deny Med-Therapy's petition for a writ of certiorari.

A. Section 29(b) Does Not Relieve A Plaintiff From The Consequences Of Its Decision To Affirm A Contract.

Section 29(b) renders a contract "merely voidable at the option of the innocent party." *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 388 (1970). *See also Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 18-19 (1979) (*Mills* recognized that Section 29(b) "confers a "right to rescind" a contract void under the criteria of the statute.").[3]

A securities fraud plaintiff must choose between rescission and out-of-pocket damages. *See Randall v. LoftsGaarden*, 478 U.S. 647, 662 (1986); *Occidental Life Insurance v. Ryan & Assoc. Inc.*, 496 F.2d at 1267

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[3] Lower courts also recognize that Section 29(b) merely gives a plaintiff the option of affirming or rescinding a contract. *E.g.*, *Occidental Life Ins. Co. v. Ryan & Assoc., Inc.*, 496 F.2d 1255, 1266-67 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974) (Section 29(b) renders a contract not void but merely voidable at the option of the innocent party); *Moody v. Bache & Co., Inc.*, 570 F.2d 523, 527 n. 6 (5th Cir. 1978) ("highly questionable" after *Mills* whether plaintiff may invoke Section 29(b) where plaintiff has sought "a remedy comparable to money damages"); *Goldman v. Bank of Commonwealth*, 467 F.2d 439, 446 (6th Cir. 1972) ("[C]ontracts subject to the Draconian language of [Section 29(b)] are...not truly "void" but more properly are "voidable" since the law in effect gives an innocent party the right to affirm or rescind.").

(counterclaimant alleging securities fraud "had the option to affirm the contract and sue for damages, or it could elect to rescind"). *Cf. Mills,* 396 U.S. at 388 ("The interests of the victim are sufficiently protected by giving him the right to rescind."). This Court wrote in *LoftsGaarden* that a Section 10(b) plaintiff, in some circumstances, may "choose between 'undoing the bargain (when events since the transaction have not made rescission impossible) or holding the defendant to the bargain by requiring him to pay [out-of-pocket] damages.'" *LoftsGaarden*, 478 U.S. at 662.

Consistent with this Court's precedent, the Court of Appeals held that Med-Therapy had to choose between remedies at trial (App. at 8-10). Med-Therapy could seek to rescind the parties' Stock Purchase Agreement, or Med-Therapy could sue to enforce that Agreement and seek damages for breach of contract and for fraud. Given this Court's prior rulings, the Court of Appeals correctly ruled that Med-Therapy could not do both (*Id.*).

Once Med-Therapy opted against rescission of the Stock Purchase Agreement, it was no longer "an unwilling innocent party" against whom the Agreement could not be enforced. *Mills*, 396 U.S. at 387. Med-Therapy willingly chose to enforce the Agreement. Med-Therapy regretted its choice after the jury returned the verdict, but Section 29(b)

did not enable Med-Therapy to elect a different, inconsistent remedy from the judge in a post-trial motion.[4]

B. This Court's Decisions Regarding The Province Of The Jury Support The Court Of Appeals' Ruling.

Med-Therapy complains that the Court of Appeals' ruling unduly limits the flexibility of trial judges when "fashioning relief" (Petition at 15, n.9). Every case Med-Therapy cites for its flexibility argument involved a bench trial. Med-Therapy's case law is irrelevant because Med-

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[4] Although the Court of Appeals focused only on the election-of-remedies principle, a waiver analysis reaches the same result. Courts have treated Section 29(b) as creating a separate implied cause of action for rescission, subject to all traditionally available equitable defenses. *E.g.*, *Regional Properties, Inc. v. Financial and Real Estate Consulting Co.*, 678 F.2d 552, 562 (5th Cir. 1982). *Cf. Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. at 19 (holding that a very similar provision, § 215 of the Investment Advisors Act of 1940, creates an implied private cause of action for rescission). Waiver and estoppel are two such equitable defenses. *Regional Properties*, 678 F.2d at 562; Gruenbaum and Steinberg, Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened," 48 Geo. Wash. L. Rev. 1, 36-37 (1979). When Med-Therapy chose to affirm the Stock Purchase Agreement and seek out-of-pocket and breach-of-contract damages from the jury, it waived any right to post-trial rescission under Section 29(b).

Therapy demanded and received a trial by jury in this case. District courts do not have broad power to change jury verdicts. The Court of Appeals properly held:

> Although the judge may have broad legal and equitable powers to order the relief necessary to effectuate the purposes of the securities laws under *Mills v. Electric Auto-Lite*, those powers are circumscribed when the judge is fashioning that relief subsequent to a jury verdict. The facts on which the judge bases his equitable or declaratory relief must not contravene the facts as found by the jury. *In re Lewis*, 845 F.2d 624, 629 (6th Cir. 1988) ("[a]ccording to the progeny of *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959), the legal claim...must be tried first before a jury and the equitable claim resolved subsequently *in light* of the jury's determination of the legal claim." *Id.*)

(App. 11) (footnote omitted).

The district court's post-trial order granted equitable relief inconsistent with the jury's legal relief. Med-Therapy blithely claims that voiding Diversicare's rights under the Note was "fully warranted under the traditional measure of damages for Rule 10b-5 claims" (Petition at 17). Med-Therapy forgets that, at Med-Therapy's election, a properly instructed jury determined the proper amount of damages.

The district court's decision increased the jury's net $1,000 verdict for Med-Therapy to a net $301,000 verdict.

The district court erred, and the Court of Appeals corrected that error. The jury's verdict was the end, not the beginning, of Med-Therapy's quest for a big judgment. *Cf. Dimick v. Schiedt*, 293 U.S. 474 (1935) (additur violates the Seventh Amendment).[5]

C. Med-Therapy Has Not Cited One Case Holding That Section 29(b) Allows A Party To Seek Breach-Of-Contract And Fraud Damages From A Jury And Then, If Disappointed With The Verdict, Seek Rescission From The Judge.

Med-Therapy's petition turns on the existence of a conflict among the Courts of Appeals requiring action by this Court. Med-Therapy's petition contains only one paragraph discussing the decisions Med-Therapy claims create this conflict (Petition at 11-12). None of these cases even suggests that a party may affirm an agreement for the purchase of securities, ask a jury to award out-of-pocket damages for fraud and breach of that agreement, and then

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[5] Even the district court acknowledged: "What is obvious to the Court is that Med-Therapy, having opted for a jury trial on a rather complex securities dispute (as it is entitled to do), and having failed to 'ring the bell' with the jury, now wishes to have a second go at it" (App. 7-8).

circumvent the jury's verdict by seeking post-trial rescission under Section 29(b).[6]

No authority holds that Section 29(b) frees a securities plaintiff from a jury's unfavorable verdict. Med-Therapy lost any right to rescission when it asked the jury to enforce the Stock Purchase Agreement and award it damages for breach of contract and for fraud. Because Med-Therapy asked the jury to enforce the Agreement, Diversicare could ask for the same. *See Miller v. Premier Corp.*, 608 F.2d 973, 983 (4th Cir. 1979) ("[A] party to [a] contract who sues to recover damages for fraud in the

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[6] The parties alleging securities fraud in Med-Therapy's cases, unlike Med-Therapy, sought rescissionary relief at trial. *See Regional Properties, Inc. v. Financial and Real Estate Consulting Co.*, 678 F.2d 552, 554-56 (5th Cir. 1982); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1036 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968); *Myzel v. Fields*, 386 F.2d 718, 740-41 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Errion v. Connell*, 236 F.2d 447, 449 (9th Cir. 1956); *Prudential Bache Secur., Inc. v. Cullather*, 678 F. Supp. 601, 603 n.1 (E.D. Va. 1987). Only one of Med-Therapy's cases, *Myzel v. Fields*, was tried to a jury, and the court in that case made no attempt to alter the jury's verdict after it had been rendered. Med-Therapy's cases therefore do not even address the issue in this case.

inducement rather than seeking rescission has thereby affirmed the contract and consequently assumed liability for its breach.").[7] Med-Therapy has not cited one case in conflict with this analysis.

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[7] Even Med-Therapy's authorities agree. "Under Section 29(b), the violating party cannot enforce the contract or sue for damages *when the non-offending party elects to terminate the contract.*" Gruenbaum and Steinberg at 17 (quoted in Petition at 13-14) (emphasis added).

CONCLUSION

Med-Therapy elected to affirm the Stock Purchase Agreement. Med-Therapy demanded a jury. The jury returned a verdict consistent with the evidence after receiving proper instructions. The Court of Appeals held that Section 29(b) did not allow the district court to overhaul that verdict and grant Med-Therapy relief inconsistent with Med-Therapy's choice of remedies and of fact finder at trial. Med-Therapy has not cited one case that conflicts with that unremarkable ruling. This Court should deny the petition.

Respectfully submitted,

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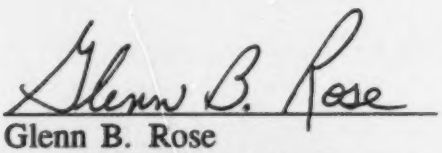
By: 
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